

COUNTY OF MONTEREY

**Management Report
For the Year Ended June 30, 2008**

Mgt. Ltr.
3/24/09

COUNTY OF MONTEREY

Management Report For the Year Ended June 30, 2007

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GALLINA_{LLP}

CERTIFIED PUBLIC ACCOUNTANTS

To the Honorable Members of the
Board of Supervisors
of the County of Monterey
Salinas, California

In planning and performing our audit of the basic financial statements of the County of Monterey (County) for the fiscal year ended June 30, 2008, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

However, during our audit we became aware of matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions and the status of our comments and suggestions concerning certain recommendations made in the County's prior year audit. We previously reported on the County's internal control in our report dated December 19, 2008. This letter does not affect our report dated December 19, 2008, on the financial statements of the County of Monterey.

Monterey County's management has provided responses to the comments described in the memorandum that accompanies this letter. We did not audit the County's responses and accordingly, we express no opinion on it.

This report is intended for the use of management, the Board of Supervisors, the Grand Jury and officials of the federal and state grantor agencies.

We thank the County's staff for its cooperation during our audit.

Gallina LLP

December 19, 2008
Roseville, California

COUNTY OF MONTEREY

Management Report Required Communication For the Year Ended June 30, 2008

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the County of Monterey (County) for the year ended June 30, 2008, and have issued our report thereon dated December 19, 2008. Professional standards require that we provide you with the following information related to our audit.

The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated June 9, 2008, our responsibility, as described by professional standards, is to express opinions about whether the financial statements represented by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the County's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the County's compliance with those requirements.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated June 9, 2008.

COUNTY OF MONTEREY

Management Report Required Communication For the Year Ended June 30, 2008

Significant Audit Findings

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the County are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the County during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Accrual and disclosure of compensated absences: Management's estimate is based on information collected in the County's payroll system using current pay rates and past experience on employee use of compensating time-off. Our audit agreed balances reported in the financial statements to those in the County's payroll system.
- Capital asset lives and depreciation expense: Management's estimate is based on past experience. We scanned depreciation listings for reasonable compliance to this approach.
- Allowance for uncollectible accounts: Management's estimate is based on past experience and subsequent collections. We reviewed management's calculation of the allowance.
- Claims liability: Management's estimate is derived from actuarial valuations obtained from experts. We agreed the claims liability reported in the financial statements to those reported in actuarial reports prepared and issued during the year being audited.
- Liability for solid waste landfill closure and postclosure costs: Management's estimate is based on engineering estimates of future costs to be incurred. We reviewed the engineer's estimate.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

COUNTY OF MONTEREY

Management Report Required Communication For the Year Ended June 30, 2008

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The following summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

| | Debit | Credit |
|--|-------------|-------------|
| Taxes Receivable | \$2,103,920 | |
| Taxes Revenue | | \$2,103,920 |
| <i>To record property taxes receivable, as of June 30, 2008.</i> | | |
| Taxes Revenue | \$1,087,407 | |
| Fund Balance | | \$1,087,407 |
| <i>To reverse property taxes receivable, as of June 30, 2007.</i> | | |
| General Government Expenditures | \$206,449 | |
| Accounts Payable | | \$206,449 |
| Fund Balance | \$239,980 | |
| General Government Expenditures | | \$239,980 |
| <i>To record liability for three months of the CSAC payment paid in FY 08/09 for the period of Apr 08 thru Mar 09 and to reverse the effect of three months paid during the fiscal year but relating to the prior fiscal year.</i> | | |

COUNTY OF MONTEREY

Management Report Required Communication For the Year Ended June 30, 2008

The material misstatements noted below were detected as a result of audit procedures and were corrected by management.

| | Debit | Credit |
|---|--------------|--------------|
| Health and Sanitation expenditures | \$8,200,010 | |
| Transfers in | \$8,455,555 | |
| Transfers out | | \$14,559,771 |
| Other Revenues | | \$211,190 |
| Charges for Services | | \$1,884,604 |
| <i>To correct classification of transfers so that they reconcile within the primary government.</i> | | |
| Fund Balance | \$2,268,747 | |
| Deferred revenues | | \$700,910 |
| General Government expenditures | | \$152,933 |
| Public Protection expenditures | | \$127,812 |
| Health and Sanitation expenditures | | \$425,505 |
| Education expenditures | | \$613 |
| Recreation and Cultural Services expenditures | | \$860,974 |
| <i>To reconcile beginning fund balances to the prior year audited balances.</i> | | |
| Property Taxes Receivable | \$11,094,786 | |
| Tax Revenue | | \$11,094,786 |
| <i>To record taxes receivable in the County's General Fund as of June 30, 2008.</i> | | |

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated December 19, 2008.

COUNTY OF MONTEREY

Management Report Required Communication For the Year Ended June 30, 2008

Consultations with Other Independent Auditors

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the County's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Supervisors and management of the County of Monterey and is not intended to be and should not be used by anyone other than these specified parties.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

DISAGGREGATION OF RECEIVABLES

Criteria

Various components of significant receivables are required to be disclosed separately in the notes to the financial statements if not visible on the face of the financial statements. Components of receivables include accounts receivable (due from citizens), taxes (property, sales taxes, transient occupancy) receivable, interest receivable, amounts due from other governments and notes receivable.

Condition

During our audit, we reclassified approximately \$50 million of receivables to properly disaggregate the County's receivables. Reclassification was determined by reviewing each of the transactions posted to the County's receivable accounts.

Cause

Currently, the County records the majority of receivables in one of two accounts: grants receivable and accounts receivable. There are no accounts to capture taxes receivable. The County's chart of accounts appropriately includes accounts for interest receivable and notes receivable.

Effect of Condition

Since amounts due from other governments includes more than just grants receivable and there are no specific accounts available to capture taxes receivable, the County's chart of accounts does not allow the County to properly disaggregate receivables as to type. By not properly disaggregating receivable amounts, the character of receivables can not be determined except through time-consuming analysis of each transaction posted to the County's receivable accounts. Note disclosure information is more accurate and the gathering process is more efficient when it is derived directly from the County's chart of accounts.

Recommendation

We recommend the County modify its chart of accounts to include separate accounts for accounts receivable, taxes receivable and amounts due from other governments. Year-end closing procedures should be modified to capture receivable balances into each of these accounts according to their nature.

COUNTY OF MONTEREY

**Management Report
Comments Pertaining to Officials and Departments – Current Year
For the Year Ended June 30, 2008**

DISAGGREGATION OF RECEIVABLES (continued)

Management Response

We disagree with this finding and recommendation. We have the accounting structure in our general ledger system to record and track the County's receivable by type. At the close of the FY, these receivables were analyzed and balanced as to type, and a comprehensive IT file was prepared and provided to the Auditors.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

RECORD PROPERTY TAXES RECEIVABLE IN THE FUNDS

Criteria

The uncollected portion of property taxes levied should be recognized in the accounts at June 30. As a non-Teeter Plan County, property taxes receivable should be reported in each fund being apportioned property tax revenue. Both current and delinquent receivable amounts from all applicable tax rolls should be included. Taxes receivable should be offset by the allowance for uncollectible taxes. Deferred revenues in the governmental funds should be adjusted to include property tax revenues collected beyond the County's period of availability (90 days).

Condition

The County currently records all property taxes receivable in Fund 50, which is classified as an agency fund for reporting purposes.

Effect of Condition

By not recording property taxes receivable in the appropriate funds, the County could materially understate receivables, deferred revenues and property tax revenues in those funds. As a result, receivables, deferred revenues and property tax revenues are not complete for financial reporting purposes.

Recommendation

We recommend the County calculate and record property taxes receivable in each fund being apportioned property taxes. The County should consider establishing an allowance for uncollectible property taxes. In governmental funds, adjustments should be made for the revenue availability period.

Management Response

We agree with this finding and recommendation. We have implemented closing procedures to analyze these revenue streams and record these transactions in the appropriated funds. In prior years these revenues were immaterial and were not booked.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

RISK PROGRAMS REPORTED IN THE GENERAL FUND

Criteria

The principal purpose of fund accounting is to demonstrate fiscal accountability.

Generally Accepted Accounting Principles permit the use of internal service funds in cases where centralized services are provided on a cost-reimbursement basis to participating funds. Although not required, the internal service fund is best designed to measure the full cost of providing goods or services for the purpose of fully recovering that cost through fees or charges to participating departments.

The use of agency funds is limited to circumstances where assets are held in a trustee or agency capacity for others and cannot be used to support the government's own programs. A government is considered to be holding assets for which it performs the investment function or with which it has significant administrative involvement.

Condition

The County uses fund 40 to account for several miscellaneous insurance programs that include dental, vision, employee assistance, long-term disability, retiree sick leave conversion and dependent care benefit programs. The benefits are funded 100% with employee contributions. Rates are set to cover premiums paid to a third-party insurer with a component built in to provide a reasonable surplus for unexpected claims. The fund is accounted for like an agency fund where revenues and expenditures are not recognized but netted in separate liability accounts. At June 30, 2008, the fund had the following account balances:

| | | |
|-----------------------------|----|------------------|
| Cash and investments | \$ | 5,276,216 |
| Accounts payable | | (287,846) |
| Claims liability | | (607,190) |
| Net balance held in reserve | \$ | <u>4,381,180</u> |

Cause

Because this fund is funded 100% with employee contributions, the cost of providing the benefit programs is netted against the reimbursements collected from employee paychecks and reported as a liability of the general fund. The fund's cash and investments, accounts payable and claims liability are also combined with the general fund for reporting purposes. However, the assets of fund 40 are not available to fund general fund obligations. The general fund's assets are not available to satisfy the obligations, including the claims liability, of fund 40.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

RISK PROGRAMS REPORTED IN THE GENERAL FUND (continued)

Effect of Condition

Because the benefits of fund 40 are entirely funded by employee contributions, fund 40 assets and obligations should not be aggregated with the County's general fund. By aggregating fund 40 with the general fund, financial reporting does not accomplish the objective of demonstrating fiscal accountability.

Recommendation

We recommend management consider the use of an agency fund type or an internal service fund type to account for the benefit programs included in existing fund 40.

Management Response

We agree with this finding and recommendation. This project is in the planning phase and will be finalized after the implementation of the new ERP-Advantage system in FY 2009-2010.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

MAINTAINING NATIVIDAD GENERAL LEDGER ACCOUNT BALANCES

Criteria

Accounting records are good only to the extent that they reflect accurate balances of the data intended to be measured. Internal controls are strengthened when pertinent information is identified, captured, used at all levels of management and distributed in a form and timeframe that supports the achievement of financial reporting objectives.

Condition

In the County's general ledger, fund 91 which represents transactions for Natividad Medical Center (Center) includes only those transactions processed by the County. This includes deposits into the County treasury, payment of claims and payroll transactions. The Center has its own external systems for processing transactions. The Center produces a monthly financial statement independent of the County's general ledger system.

Cause

There are transactions on the Center's system that are not reflected in the County's general ledger. Transactions not included in the County's system include patient receivables, capital assets, inventory and debt balances. Transactions between the two systems are not reconciled to each.

Effect of Condition

The monitoring element of the internal control environment is enhanced when accurate financial information is used internally to monitor the Center's financial condition and progress towards financial objectives and goals. Inaccurate or incomplete financial information can significantly impact management's ability to effectively make important financial decisions.

Recommendation

As the Center produces a monthly financial report that includes all of its transactions from all sources, we recommend the County reconcile its balances with the external report and update its general ledger balances to accurately reflect all transactions and balances for the Center.

Management Response

We agree with this finding and recommendation. The ERP team is currently working on a "bridge" system to transfer data from the Natividad Medical Center Meditech general ledger to the County's Advantage general ledger. After this interface is completed, there will be seamless transfer of monthly financial data to the County's general ledger, and will be reconciled accordingly.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

ACCOUNTING AND REPORTING TRANSFERS

Criteria

GAAP define an interfund transfer as a flow of cash or other assets from one fund to another when there is no reciprocating flow of any item of value back to the fund originating the transfer and no liability is created for the receiving fund to repay the originating fund. In essence, a transfer constitutes a gift or subsidy from one fund to another. When such a transfer is recorded, the incoming transfer recorded in the receiving fund must be identical in amount to the outgoing transfer recorded in the paying fund.

Transactions that involve an exchange between funds where each fund is contributing assets or services to the other fund are accounted for as reimbursements or simply as interfund charges, depending on the fund types involved in the transaction.

Condition

During our audit, we noted that the total amount recorded as incoming transfers from all funds did not equal the total amount recorded as outgoing transfers for all funds on the final trial balance provided by the County and also on the worksheet provided in connection with the audit. Some transactions are recorded as transfers by one fund but recorded as revenue or expenditures by the other fund.

Cause

Fund 91, Natividad Center, reported transfers-in of \$8,200,013. These transfers were for sales tax realignment allocations and should have been reported as revenue. Fund 91 also reported transfers-out of \$6,326,523. These transfers were California State Health payments and should have been reported as expenditures.

Effect of Condition

If true transfers of resources between funds are not simultaneously recorded as incoming transfers in receiving funds and outgoing transfers in paying funds, then by definition the transaction has been recorded incorrectly and revenues and expenditures in the affected funds will likely be misstated. Although such misstatements are likely to be identified before the financial statements are finalized, the process of evaluating and correcting the transactions after they have already been recorded can be time-consuming. In addition, if the transaction in question constitutes a reimbursement or charge for goods or services and not a true transfer, recognizing either a transfer in or a transfer out would result in a misstatement both of transfers and of the affected funds' revenues and expenditures.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

ACCOUNTING AND REPORTING TRANSFERS (continued)

Recommendation

We recommend the transactions identified above be recorded appropriately as revenue or expenditures as indicated. We also recommend that the Auditor-Controller's Office balance the incoming and outgoing transfer accounts during the closing process so that discrepancies can be identified and corrected.

Management Response

We disagree with this finding and recommendation. We have provided an IT file that shows the complete reconciliation of all transfers in/out with Fund 91-Natividad Medical Center.

COUNTY OF MONTEREY

Management Report Comments Pertaining to Officials and Departments – Current Year For the Year Ended June 30, 2008

PAYROLL/PERSONNEL FUNCTIONS

Criteria

Segregation of incompatible functions is critical to good internal control policies. In the area of payroll, the functions of human resources that include maintaining personnel files, pay rates, adding employees and removing employees should be segregated from the function of payroll processing. The risk of fraud is significantly reduced when the functions are segregated not just with departments and paper documents but also by means of a software solution.

Condition

We observed that the Auditor-Controller's office is responsible for maintaining personnel records as well as handling payroll functions. This was a prior year condition.

Effect of Condition

The effect of this condition results in a lack of segregation of duties between the personnel functions, which are usually handled by the Human Resources department, and the payroll function. It is imperative that these functions be segregated. In most Counties, especially the larger ones, the Human Resources department maintains personnel files, including the updating of pay rates, obtaining approvals for withholdings and deductions, and approvals for direct depositing, etc. If the Auditor-Controller's office has the ability to change pay rates and handle other details of personnel files, then errors or fraud could occur and not be detected in a timely manner.

Recommendation

We recommend that the functions of personnel and payroll be separated by transferring the duties of the personnel functions from the Auditor-Controller's office to the Human Resources department.

Management Response

We agree with this finding and recommendation. The County is currently implementing a "new" payroll system that will address these issues. Implementation of this ERP package should be completed by the close of the FY 2009-2010.

COUNTY OF MONTEREY

Status of Prior Year Recommendations
June 30, 2008

| Recommendation | Status |
|--|-----------------|
| <u>AUDITOR-CONTROLLER</u> | |
| <u>Payroll/Personnel Functions</u> | |
| We recommend that the functions of personnel and payroll be separated by putting the duties of the personnel functions in the Human Resources department. | Not Implemented |
| <u>Deferred Revenue</u> | |
| We recommend that deferred revenue balances be tracked and reconciled throughout the year. Subsidiary schedules should be prepared for every deferred revenue account. These schedules should track the increases and decreases of the account. Each schedule should show the purpose of the account, the trigger for the recognition of revenue, the increases in the account, the amounts that are recognized, and the ending balance of the account which should agree to the General Ledger. | Implemented |
| <u>VARIOUS DEPARTMENTS</u> | |
| <u>Payroll/Personnel Functions</u> | |
| We recommend that where possible the functions of initiating hiring and entering the time for all employees be segregated and performed by separate individuals. While we understand that a complete segregation of duties is impractical in a small department with limited personnel, we believe that some relatively minor changes could be made that would significantly improve controls. These duties can be rotated among department staff or someone else outside the department could be assigned to learn how to perform these duties and to actually perform them periodically to reduce the chance of errors and fraud from occurring and not being detected in a timely manner. | Not Implemented |